May 2010

Small Business Employment: Tighter Credit Standards Slow Hiring

Small businesses comprise the majority of companies in the United States, with 75 percent of employees working for establishments with fewer than 250 employees. These small firms are the backbone of the American economy, generating innovation, growth, and jobs.

Small businesses have been especially hurt by the tighter lending standards that resulted from the financial crisis. Tighter lending negatively impacts small business operations, expansion opportunities, and hiring because small businesses do not have access to the alternative forms of funding available to larger firms.

This report uses previously unpublished data to show that lending to small businesses continues to remain tight, and that as a result, hiring by small businesses remains depressed while hiring by larger establishments has picked up.

Report by the U.S. Congress Joint Economic Committee
Representative Carolyn B. Maloney, Chair
Senator Charles E. Schumer, Vice Chairman

Prepared by the Majority Staff of the Joint Economic Committee

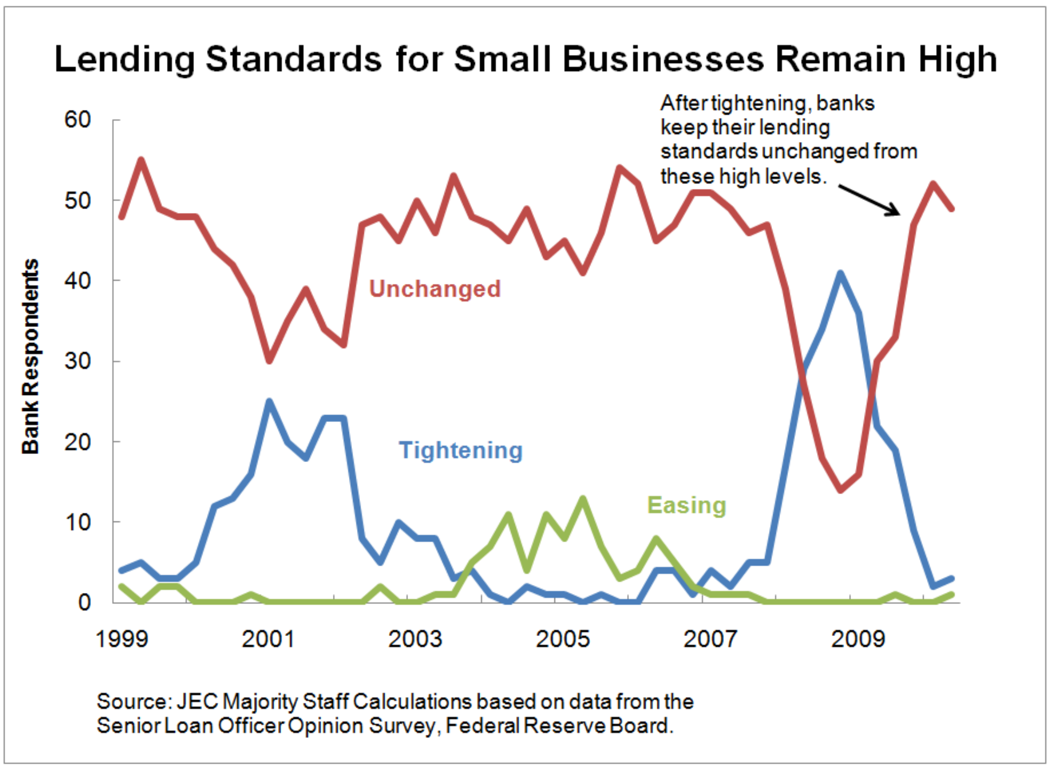
Background

In recent testimony before the Joint Economic Committee, Dr. Alan Krueger, Assistant Secretary for Economic Policy and Chief Economist at the Treasury Department, highlighted the recent gap between hiring at large and small businesses, using previously unpublished Job Openings and Labor Turnover Survey data (JOLTS) from the Bureau of Labor Statistics. This report analyzes that same JOLTS data, which was made exclusively available to the U.S. Congress Joint Economic Committee, to better understand small business hiring between January 2001 and March 2010. Small business hiring remains well below its 2001-2007 average level. Since mid-2009, hiring among small businesses has continued to trend down, even as hiring by larger firms has increased.

The charts that follow make clear that small business lending remains tight and that small business hiring is well below that of larger firms and well below its average level over the past decade. Additional actions are needed to spur lending to small businesses and to help small businesses fully participate in the recovery that is now underway.

Credit Availability for Small Businesses

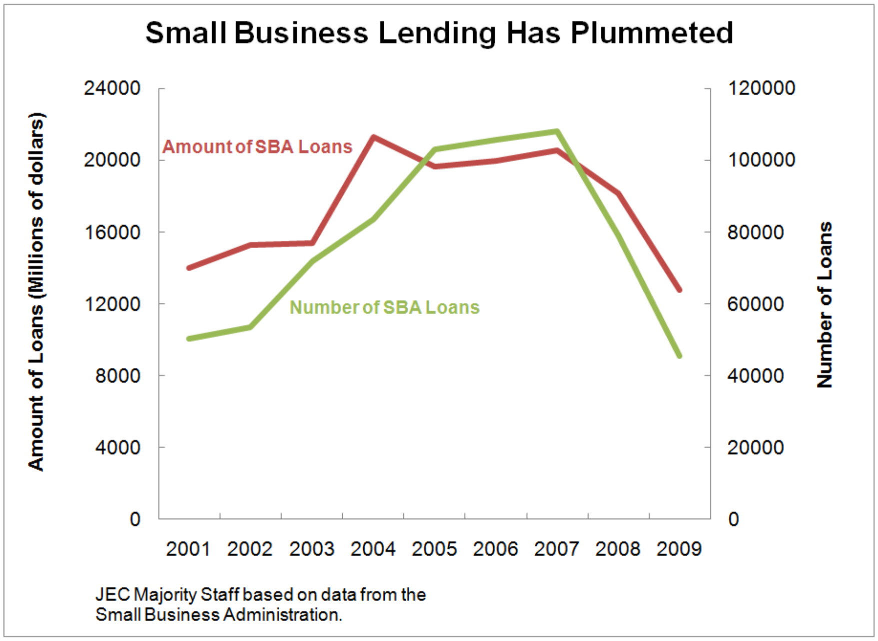
Small businesses generally borrow money from banks. Larger firms can use stock offerings and/or corporate debt such as bonds or commercial paper in addition to borrowing from banks. When the financial crisis hit, many banks began to restrict their lending by tightening their lending standards.



Today, despite the growing signs that the economy is improving, many small businesses are still unable to access credit. Most banks, which tightened their standards for small businesses at the onset of the financial crisis, have left their lending standards unchanged at these tighter levels. A few banks continue to tighten their lending standards further.

Lending to Small Businesses

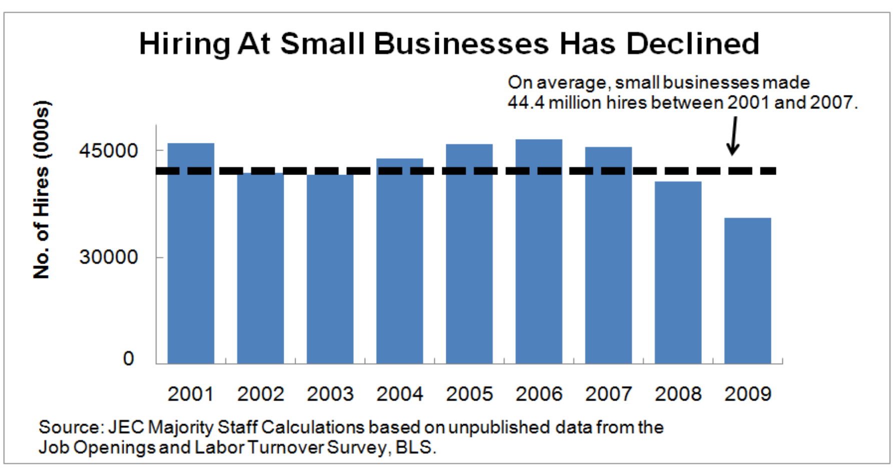
While information on small business loan origination is limited, data from the Small Business Administration (SBA) reveals a decline in both the number and amount of loans given to small businesses.



Under certain circumstances, when a small business requests a loan from a bank or financial institution, the bank considering the loan application has the option of requesting that SBA guarantee a portion of the loan. The SBA guarantee provides a bank with assurance that its investment will be returned. As a result, the guarantee extended by the SBA should encourage more lending to small businesses. However, the number and amount of small business loans guaranteed by SBA has fallen considerably since the start of the Great Recession.

Hiring Among Small Businesses

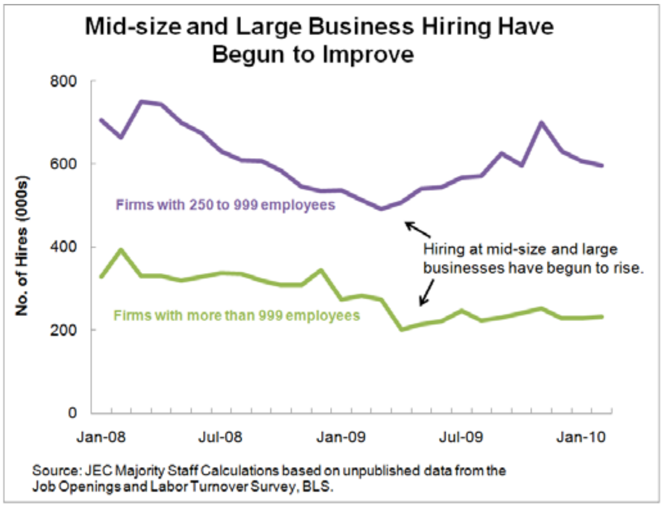
The majority of workers (about 75 percent) are employed in small businesses. Although the bulk of new hiring is also done by small businesses, the rate of hiring at smaller establishments has steadily declined since the start of the recession.[1]

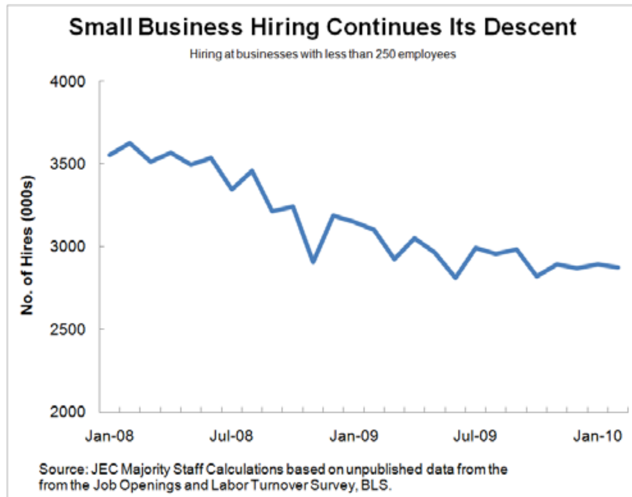


The tightened credit conditions experienced by small businesses have curtailed their ability to meet payroll or produce the products and services that are in demand. In the years leading up to the recession, small businesses hired an average of 44 million people annually.[2] Small business hired only 40 million workers in 2008 and 35 million workers in 2009. In 2009, small business hiring was 20 percent below its 2001-2007 average.[3]

Hiring: Small Business vs. Mid-size and Large Business

As further evidence of the impact that tight credit markets are having on small businesses, hiring in mid-sized and larger establishments has been increasing since the middle of 2009 while small business hiring continues to decline.





Although financial markets have begun to thaw, driving down borrowing costs demanded by investors, financial institutions continue to offer loans under very tight credit terms. While large and mid-size firms can circumvent the higher costs of financing, small businesses are forced to either accept the higher terms or reduce their borrowing.

Conclusion

Despite the significant role played by small businesses in our economy, small businesses often operate at a disadvantage to their large and mid-size peers. While large and mid-size firms can often access credit through either credit markets or financial institutions, small businesses' credit access is typically restricted to financial institutions. Although financial markets have begun to normalize, driving down borrowing costs demanded by investors, financial institutions continue to offer loans under very tight credit terms.

Since job creation in our economy depends greatly on the activities of small businesses, every effort should be made to ensure their viability. Improving credit availability for small businesses will ensure that our economy maintains its flexibility and growth, which can go a long way toward creating jobs.

---

1. Unpublished data from the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey.
2. *Ibid.*
3. *Ibid.*